Theoretical and Methodological Aspects of Corporate Governance

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Abstract.: **The features of corporate governance are considered. In modern realities, the quality of management is determined by the internal organization (a clear corporate strategy with the definition of the goals and interests of the company). A model of company management is proposed, which takes into account the interests of not only the owners, but also other interested participants.**

Keywords: corporate governance; Board of Directors; theory of agency relations; innovation management.

I. INTRODUCTION

The company is created through the pooling of capitals. It is assumed that the owners (shareholders) must act harmoniously, observing the rules of corporate ethics, guided by a common goal - to ensure the stable operation of the enterprise.

It is a well-known provision of corporate law that a shareholder is not the only interested party. The interested parties are also creditors, labor collective, society, public authorities [3]. In particular, a joint stock company should be socially responsible. In this regard, when making strategic decisions, the management body must take into account the interests of other interested parties, including employees, creditors, and contractors of the company.

Modern economic literature examines the problems and shortcomings of corporate governance, emphasizes the urgent need for its improvement, raises questions that are very important from a theoretical point of view and related to the practice of corporate governance about management objectives, functions and responsibilities of boards of directors, shareholders' rights and control over a corporation, and directions. overdue changes.

II. LITERATURE REVIEW

Linda Hill (Harvard Business School professor) and George Davis (executive vice president of MacAndrews & Forbes) (3) note that the core tasks of boards of directors are shifting from monitoring how corporate management manages risk, to encouraging radical innovation in pursuit of for a competitive advantage. The style of their work is changing. Tackling innovation and risk-related challenges requires boards and senior management to develop new models of collaboration in order to fundamentally improve the partnerships between them and add value to the boards for the company's success.

However, the need for novelty is not always accompanied by the presence of the corresponding ability. The survey carried out by the authors showed that most directors are just beginning to pave their way towards solving the problems of regulation of innovation. Boards of directors are penetrating the need to support management in developing an active innovation strategy, which also includes the ability to maximize risk mitigation and risk management. But here they are faced with the paradox of risk: it turns out that avoiding risk becomes the riskiest option. In today's hectic environment, waiting and standing still are not considered the right behavior.

III. ANALYSIS AND RESULTS

Top management naturally has more power than board members in making key decisions, but without full board support, management is unlikely to take full responsibility for innovation. In fulfilling their growing role in leading innovation, board members face a number of challenges and frustrations. Hill and Davis point to the following weaknesses that need to be addressed [3].

- Obsolescence of the innovation and risk management agenda. Most of the councils focus on innovations to ensure the implementation of the current strategy, including those related to expanding the product line, reducing costs, improving customer relations, complying with new regulations, and cybersecurity. Overemphasis on short-term results inhibits innovation; the company is keen on partial improvements instead of breakthrough, and sometimes more risky initiatives, but capable of updating the business.
- Lack of time. Regular discussion of innovation issues in the councils turns out to be an “unaffordable luxury”. Directors complain of overwhelming financial monitoring and

compliance issues, especially in industries subject to regulatory changes (eg, finance, energy, healthcare). Even in successful companies, it is difficult to find the time it needs to innovate.

- Lack of competence. The councils often lack the level of industry knowledge and innovative experience necessary for an informed assessment of the real value and degree of justification of the risk of an innovative project.[5]
- Lack of productive interaction between the board of directors and management. In the traditional model of corporate governance, the role of management was to present the strategy and the board of directors to approve it. While many consider this practice to be outdated, mastering new roles in the strategic planning process is proving to be the most challenging task.

The idea that the goal of management is to maximize shareholder wealth (i.e., the market value of a company) is critically scrutinized, which raises a host of other challenges, from evaluating results to shareholder rights, the role of boards of directors, and allocating responsibilities.[6]

Joseph Bower and Lynn Payne (professors at Harvard Business School) associate this approach to corporate governance with the theory of agency relations proposed by economists in the 1970s (M. Friedman, M. Jensen, W. Meckling), according to which shareholders own a corporation, and therefore, they have the power and the right to demand the conduct of business in accordance with their interests. This formulation of the question looks quite natural, but a more attentive approach reveals that it is legally untenable and touches on the most complex problem of responsibility [2].

A consequence of the agency approach to corporate governance, the authors point out, is a responsibility vacuum, which affects strategy and resource allocation, weakens companies, and, if widespread, can pose a threat to the entire economy. [7] Thus, Jensen and Meckling denied the social responsibility of corporations, mistakenly defining a corporation as an "individual," Friedman believed that it was an "artificial person" and could not be given responsibility. Over the past decades, this model has served as the basis for a number of changes in corporate governance and management practices that have increased the power and influence of certain types of shareholders to the detriment of others and other stakeholders, while not creating adequate responsibility and accountability of these power holders. As a result, managers are under increasing pressure to prioritize more profitable and faster return on investments, reducing the cost of meeting the needs of the future.[8]

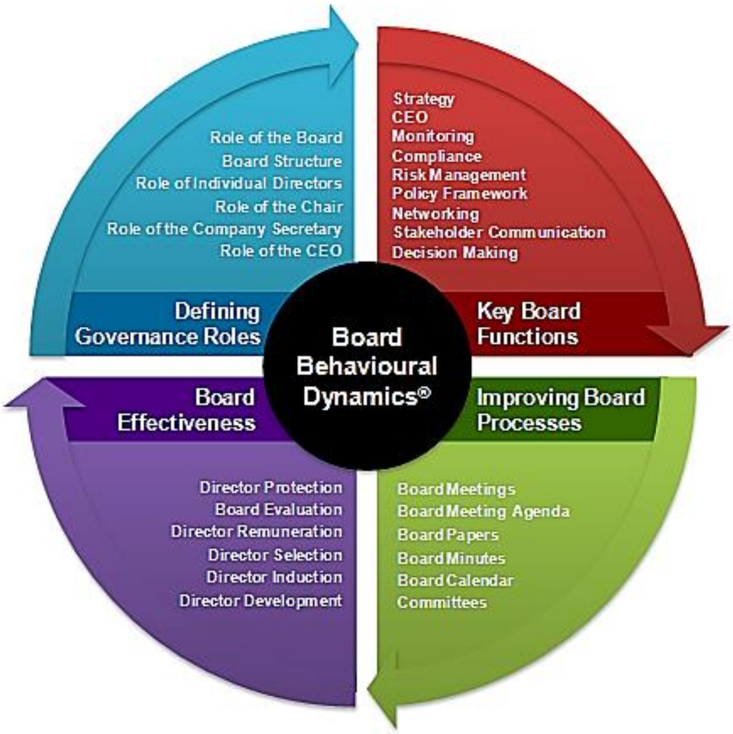

Figure 1. Image sourced from www.effectivegovernance.com.au on 19 September 2016 [16]

The authors emphasize their belief that broad participation in the economy through the ownership of PC shares fulfills an important social function, and this necessitates reliable protection of shareholders' rights. At the same time, the health of the economic system depends on the correct perception of the role of shareholders. The agent model, in its extreme interpretation, is erroneous in theory and detrimental to practice. A more informed approach is to recognize the essential role of shareholders, but at the same time perceives corporations as independent economic entities with multiple goals. Such an approach should include legal principles under which board members and managers have obligations to both the corporation and shareholders. In other words, a more advanced model should have a greater focus on the company [9].

Having considered the theory of agency relations, the authors come to the following conclusions. First, it is contrary to corporate law, i.e., legally, shareholders do not have the rights of "owners" of the corporation, and managers are not their "agents". Second, this theory does not correspond to practice: shareholders not only do not own the company in the traditional sense, but also do not have the traditional incentives for owners to take care of its management. This observation is even more true today than in 1932, when A. Berley and G.Means expressed it in their famous book. About 70% of the shares of the US PC are held by mutual funds, pension funds, insurance companies, sovereign wealth funds and other institutional investors, whose managers are judged and rewarded on the performance of the entire investment basket. Third, shareholders are not responsible for the actions of the company or for the protection of its interests, like its officers and directors, which makes them indifferent to the broader and long-term aspects of its activities. Fourth, the concept of aligning the interests of shareholders and managers in agency theory is fraught with moral hazard and can distort the perspective of the entire organization. Fifth, the theoretical assumption of the uniformity of shareholders' interests is an oversimplification and contradicts the facts.[10]

Despite these shortcomings, agency theory has attracted considerable attention and, in practice, has influenced a number of areas of corporate governance, which in general have strengthened the role of shareholders and contributed to the development of a corporate governance model that has an unconditional focus on their interests. This theory influenced such aspects of the organization of management as the remuneration of senior corporate officials, the rights of shareholders in relation to boards of directors, the rights of the boards themselves, the positions of managers, investment strategy, etc. For example, if funds that could be invested in future profits, are simply paid to shareholders and are not used to fund R&D, organize start-ups or expand existing enterprises, they are spent without creating any new value. Shareholder returns are often simply the transfer of funds from the public wallet.[12]

Good governance is ensured by accountable managers, says Einat Edmati (professor at Stanford University School of Business). However, the real problems of corporate governance do not fit into the usual economic frameworks and models; they are adorned with a parade of scandals and crises that have caused significant damage. The effective management of both private and public sector organizations means that their officials are prevented from evading responsibility by claiming that the causes of damage were outside their control, when in fact they could and should have taken measures to prevent it. [1]

Edmati notes the phenomenon of "financialization" of corporate governance that has emerged in recent decades in connection with the general trend of increasing importance of the financial sector, financial markets and financial activity in the economy. Within the framework of corporate governance, this was reflected in the remuneration of managers, its dependence on financial indicators - profit, share prices, return on equity. These phenomena not only do not always correspond to the benefit of shareholders, but, moreover, do not meet the public interest. The financialization of corporate governance creates incentives for distortion and even falsification of reporting, evasion of compliance with the law, and official misconduct. Such incentives lead to a focus on short-term tasks and other manifestations of ineffective allocation of resources, poor risk management (1).

An improved model of corporate governance, according to Bower and Payne, should focus on the health of the enterprise, not on the short-term benefits of its shareholders, to recognize the reality of corporate governance in the long term and in the interests of all, not just the most active shareholders. An approach to corporate governance is needed that emphasizes the essence of the corporation as a social institution and the objectives of its sustainable functioning, strengthens the role of boards of directors and a system of accountability, broader than accountability to shareholders, and promotes a long-term approach to strategy development and allocation of resources. From this point of view, the following principles are proposed that create a more realistic basis for corporate governance [2].

1. Corporations are complex organizations that depend on talented leaders and managers to function effectively.
2. The long-term prosperity of corporations is possible only with their ability to learn, adapt and regularly renew themselves.
3. Corporations simultaneously perform many functions in society, including providing investment opportunities, creating wealth, producing goods and services, providing employment, technological development, paying taxes, etc.
4. Corporations have different goals and have different strategies to achieve them.
5. Corporations are required to create value for the entire structural set of stakeholders within the free market system (consumers, employees, suppliers, shareholders, population).
6. Corporations must have ethical standards that govern their interactions with their stakeholders, including shareholders and society as a whole.

7. Corporations are embedded in a political-socio-economic system, the health of which is vital to their sustainable existence.
8. The interests of a corporation are special in relation to the interests of any particular shareholder or group of stakeholders.[11]

From a practical point of view, the implementation of these principles will mean increased attention to such aspects of corporate governance as a forward-looking strategy for growth and renewal, investment in innovation, risk analysis, political and environmental factors; a closer connection between the remuneration of managers and the achievement of strategic goals; a strategic rather than narrowly financial approach to resource allocation; better use of financial leverage to counter market volatility; great concern for social responsibility and compliance with ethical standards, etc. However, such a corporate governance model will not free corporations from the need to provide a payback that matches the cost of capital raised. At the same time, they will be able to use a wider range of strategic positions and more actively attract investors who share their objectives (2).

In the search for new ways of corporate governance of innovation, many corporate councils are revising both their composition and the way they work. Based on their research, Hill and Davis point to the following directions for improving management [13].

1. Diversity and collective literacy. Boards of directors should take a thoughtful approach when joining or replacing members, selecting professionals whose experience and expertise complement both other directors and managers. Now, in many cases, it is desirable to attract people with technological experience, the so-called "digital directors" who are able to solve innovative problems and assess the volume of investments in technology development. The composition of the councils should take into account the desirability of a variety of problem-solving competencies, as well as representativeness in terms of stakeholder interests. In practice, there are also examples of attracting young candidates based on their potential rather than experience, which is a decisive departure from the traditional approach.[14]
   Effective collaboration requires the exchange of knowledge and experience, which is why leading companies are working to form "collective literacy" advice, especially in the field of industry development prospects, using various techniques, including inviting experts to conduct "master classes", holding sessions with venture capitalists, visits to research centers, meetings with key consumers, etc.
2. "Creative tension" stimulates thinking and innovative ideas. This requires the creation of a space for ideas resulting from careful discussion and exchange of views. Today it seems necessary for innovative problem solving. Critical thinking is necessary, and this involves bringing a certain tension into the discussion. Even "some chaos" at meetings is allowed to involve management in creative thinking. Boards should develop an appropriate culture that allows opposing opinions but avoids excessive confrontation that can stifle the urge to propose ideas.
3. Establishing a new nature of the partnership between the board of directors and management. A balance of legal powers of the first and the executive power of the second is needed, an awareness of their shared responsibility for the innovation strategy. Neither side should dominate. The study showed that managers are increasingly striving to increase their receptivity to discussions, expecting more participation from directors. The real attitude towards partnership represents a change in traditional relationships. Examples point to the recognition of the importance of trust, openness when criticizing and discussing complex issues, and the need for special preparation for such procedures. [2]
4. Encouraging risk and tolerance for failure. A proactive innovation strategy requires a culture that understands risk and inevitable failure correctly. At the same time, all joint efforts should be directed towards the risk-taking that is associated with the most likely success in the long term. The difficulty lies in determining the potential return on investment.[15]

Hill and Davis emphasize that one of the biggest challenges is the relationship between a company's short-term financial performance and other indicators that reflect the effectiveness of innovation and improved competitive position in the long term. Some councils are beginning to use criteria reflecting the functioning processes, or indices of innovativeness (the share of revenues from the sale of new products and services in the total turnover). Most innovations are known to be unsuccessful, which is why early detection of the futility of an innovation initiative becomes so important, which must also be taken into account when planning innovations and which is within the sphere of control of the board of directors. As the study shows, an increasing number of boards of directors are adopting new norms of functioning, forming new relationships with management, which ultimately should contribute to the effectiveness of innovation processes [3].

According to Edmati, the keys to improving corporate governance are increased transparency, improved mechanisms for internal and external control and accountability, and the adoption of effective laws and regulations. In turn, the effectiveness of corporate governance is associated with the effectiveness of government regulation of management practices through the adoption of legislation and regulations, as well as enforcement of contracts and norms. In the context of financialization, corporate leaders will aggressively strive to achieve market power and discourage new competitors from entering the industry. In this regard, legislation should be aimed at strengthening antimonopoly regulation, supporting competition, facilitating the entry of new participants, ensuring information transparency, punishment for abuse, etc. Such measures were adopted in the USA (Sarbanes-Oxley laws of 2002 and Dodz-Frank laws of 2010), however, according to Edmati, they are insufficient [14].

IV. CONCLUSIONS

Hence, the increased attention to the institutional aspects of corporate governance, the role of financial and legal institutions. Thus, international comparisons of the practice and effectiveness of corporate governance led researchers from the universities of Florida and Maryland (USA), the University of London, York University (Canada) and the National University of Singapore (4) to the conclusion about the importance of such factors as the legal regime, corporate culture, level corruption, about the inextricable link between corporate governance and the entire system of public institutions. Associated with this is a departure from a universal approach to the organization and efficiency of corporate governance and the conclusion that management problems at the firm level are not universal and may differ depending on the institutional environment. Therefore, the characteristics of the boards of directors, their structure, tasks, principles of formation can be significantly different. For example, in some jurisdictions, unlike unitary councils, two-tier boards (including supervisory boards) are created. The studies note that unitary councils are typical for countries of common (case-law) law, and two-tier councils are common in countries of civil law. An important role is played by regulatory regimes, financial reporting standards, and the information environment. Financial disclosure, according to researchers, is an important mechanism of corporate governance, strengthening of relevant regulatory requirements plays a positive role, serves as an incentive to build confidence on the part of investors.

Adequate oversight, regulation and enforcement are essential, Edmati stresses, because free and open markets are not always competitive and free from abuse and fraud. Legal rules defining limited liability and the independent legal status of corporations contain certain benefits, but they also create problems of conflicts of interest, and lack of personal responsibility exacerbates them. Interaction between governments and corporations can increase efficiency and reduce distortions that serve the interests of the few. [1]

By transferring the research to the international level, experts from the USA, Great Britain, Canada and Singapore (4) pay attention to the role of foreign investors and corporate directors. It is noted that the legal system and regulatory bodies at the country level facilitate the participation of foreign investors in corporate property, the attraction of foreign financial capital and foreign board members. Thus, a relationship arises between foreign ownership and the participation of foreign directors on boards, and this interaction is influenced by cross-country differences in legal systems, regulatory systems, and political structures, and affects corporate governance.

The authors also draw attention to the phenomenon of international mobility of corporate governance practice, which is becoming increasingly important. Mobility in this context means the transfer of structures and processes (export or import) when internationalizing a corporation's activities, for example, acquiring a foreign subsidiary. A local firm can import foreign management practices by appointing foreign directors to its board or by attracting foreign investors through cross-listing on foreign exchanges. There are four interrelated channels of such international corporate governance mobility: 1) mergers and acquisitions; 2) foreign ownership; 3) foreign members of the board of directors; 4) foreign political ties. According to researchers, overseas acquisitions are beneficial to both parties, especially firms operating in very different institutional settings. Foreign investors influence the behavior of managers and can also have political influence. International relations of directorates have a positive effect on the market value of the firm, especially in countries with underdeveloped legal regulations. Policy makers are encouraged to promote corporate governance mobility, and national regulators are encouraged to work together to promote international standards.

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